Court of Appeals No. 52945-9-II

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

ADAM ROSEN, an individual; DAVID ROSEN, an individual; and MATTHEW ROSEN, an individual; individually and derivatively on behalf of ROSEN SUPPLY COMPANY, INC., a Washington Corporation,

Appellants,

v.

HARVEY ROSEN, an individual; and DIANNE ARENSBERG, an individual,

-and-

ROSEN SUPPLY COMPANY, INC., a Washington corporation,

Nominal Defendant,

Respondents.

APPELLANTS' CORRECTED OPENING BRIEF

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I. INTRODUCTION

Plaintiffs Adam, David, and Matthew Rosen ("Plaintiffs") filed this lawsuit to protect Rosen Supply Company ("RSC"), the family business where they have worked for their entire professional careers, from being taken over and sold by Defendants Harvey Rosen and Dianne Arensberg ("Defendants"), in violation of the company's Articles of Incorporation (the "Articles") and other governing rules.[1]

Plaintiffs are in their fifties and have each worked at RSC for decades. From the beginning, they have consistently relied on the promise that RSC, a plumbing supply company based in Tacoma, would remain a family business, and that they would one day have a chance to transition it to their children and other members of the fourth generation of Rosens. That reasonable expectation is enshrined in RSC's governing documents, which protect the company, its owners, and its employees from oppression by rogue shareholders. These include the Articles, the original Bylaws, and, in particular, a Stock Purchase Agreement entered in 1989 (the "1989 SPA"), which provides that shareholders may only sell their stock, if at all, either to RSC's other shareholders or to the company itself. Each of these documents was structured to preserve RSC's character as a family

[1] Because all of the parties except one have the same last name, to avoid confusion Plaintiffs refer to them below by their first names.

business, and to prevent precisely the kind of misconduct in which Defendants engaged here.

Indeed, Defendants have admitted to the existence of such restrictions on RSC's status as a family business, but want to avoid them so they can sell the company and cash out. For these purely self-serving reasons, Defendants decided they no longer want to abide by the terms of the 1989 SPA. They therefore claimed the right—as owners of a majority of RSC's outstanding ***shares***—to disregard it. But unchallenged evidence shows they have no such right, because Defendants represent less than a majority of RSC's six ***shareholders***.

At its core, this appeal asks whether the shareholders of RSC vote on a per shareholder basis (i.e., per capita), or on a per share basis. This matters because Defendants have purported to reconstitute RCS's board of directors, amend its bylaws, and prepare the company for a third party sale over Plaintiffs' objection—solely on the basis that they own a majority of RSC's outstanding shares.[2] The trial court erroneously endorsed their position. In so doing, it overlooked Defendants' admissions (1) that RSC's founders intended for RSC to remain a Rosen family business in perpetuity and structured the company that way, and (2) that Defendants

[2] Harvey's son Devin Rosen is also an RSC shareholder, and has voted in support of Defendants' attempt to seize control of the company. But his support merely creates a 3-3 split among the shareholders.

simply do not want to be bound by that structure anymore. Yet all of RSC's governing documents reflect an intent to keep RSC in the Rosen family, and each of them guards against a minority of RSC's shareholders selling the company out from beneath their family members.

According to Defendants' sworn testimony below, they no longer have to abide by those governing documents and principles, because "markets have changed" and "[i]t's pretty hard to live under an agreement [the 1989 SPA] that was done 40 years ago." CP 120 (162:8–163:3). In order "to take advantage of the market," Defendants claimed the power to disregard the founders' intent and to sell RSC to the highest bidder over the objection of half of RSC's shareholders. They have no such power, and the trial court erred in concluding otherwise. Defendants' actions, purportedly approved at a "Special Joint Meeting" on December 1, 2017 (the "Special Meeting"), were unlawful.

Since Plaintiffs' grandparents, Max and Sara Rosen, started RSC in 1946, four generations of Rosens have worked there. All six current shareholders are members of the Rosen family. Defendants are part of the second generation and Plaintiffs are part of the third, along with their cousin Devin Rosen (Harvey's son and Dianne's nephew). For purely financial reasons, and because they have already reaped the benefits of working at the family business for decades, Defendants now only care

about selling RSC to the highest bidder and cashing out—regardless of whether their actions violate the company's shareholder voting rules and stock purchase agreement.

In the fall of 2017, Defendants made a final threat to Plaintiffs: either pay an exorbitant price for their RSC shares or face a third party sale. They then issued a notice of a Special Joint Meeting of the Board and Shareholders, with proposed shareholder resolutions that sought to remove David, Matt, and Devin as directors (leaving only Harvey, Dianne, and Adam), and to amend and restate the Bylaws to specify that voting was "per share." Plaintiffs informed them no action could take place without the approval of a majority of RSC's six shareholders.

Over Plaintiffs' objections, Defendants proceeded to hold the meeting, and incorrectly declared the resolutions had passed because the holders of a majority of shares had voted in favor of them. In other words, Defendants have taken the untenable position that, despite plain language in RSC's Articles of Incorporation requiring shareholder voting on a per shareholder basis, they can, as the holders of a majority of RSC's shares, sell the family business to a third party over Plaintiffs' objection. They cannot. Defendants have never controlled RSC. They are only two of six shareholders. And even when supported by Devin (Harvey's son and Dianne's nephew), they constitute only 50 percent of the shareholders.

Without support from at least Adam, David, or Matthew, Defendants are prohibited from removing or adding directors, amending RSC's Bylaws, or selling RSC.

To protect RSC from Defendants' unlawful attempt to seize control in derogation of RSC's governing rules, Plaintiffs filed this lawsuit for declaratory relief. The parties filed two sets of cross-motions for summary judgment, which, among other things, asked the trial court to resolve the narrow legal question of whether RSC shareholders must vote on a per shareholder or per share basis. The trial court erroneously granted Defendants' request for declaratory relief on that issue, ruling without explanation that "RSC's voting regimen is one share, one vote . . . and not on a per capita voting basis." CP 649.

The trial court erred. Adam, David, and Matthew should have prevailed on summary judgment. Accordingly, this Court should vacate the declaratory judgment entered below, and remand with directions to enter summary judgment in favor of Adam, David, and Matthew.

II. ASSIGNMENTS OF ERROR AND ISSUES ON APPEAL

1. The trial court erred in issuing declaratory judgment that RSC's Articles establish a "one share, one vote" regimen, and granting other relief to Defendants on that basis.

Issue: Must the votes of RSC shareholders be counted on a "per shareholder" or "per share" basis?

2. The trial court erred in granting partial summary judgment in Defendants' favor on the issue of whether the 1989 SPA dictates that there is "no limitation on RSC's right to sell substantially all of RSC's assets, cease doing business entirely, liquidate RSC, or exercise such other rights as are available consistent with the corporate law of the state of Washington."

Issue: Do RSC's governing rules preclude a minority of RSC shareholders from selling substantially all of RSC's assets, ceasing doing business entirely, or liquidating RSC?

3. The trial court erred in compelling RSC to provide mandatory indemnification to Defendants for the legal expenses they incurred in defending against Plaintiffs' claims.

Issue: Were Defendants entitled to mandatory indemnification by RSC under RCW 23B.08.520, RCW 23B.08.540(1) and Article XI of RSC's Amended and Restated Bylaws?

4. The trial court issued an erroneous finding of fact that defense counsel spent a "reasonable amount of hours in connection with this proceeding, given the complexity of the legal issues presented, the tasks necessary to be completed and the significance of the matters at

stake," despite its correct findings that "there was duplication of effort by different attorneys" and that certain of Defendants' lawyers worked an "excessive amount of hours spent on tasks in each category."[3]

Issue: Was the overall amount of time spent by defense counsel litigating this matter on Defendants' behalf reasonable?

5. The trial court issued an erroneous finding of fact that that the expenses defense counsel incurred litigating this matter on Defendants' behalf between December 1, 2017 through October 31, 2018 were reasonably valued at $420,930.60.[4]

Issue: Did the trial court adequately reduce the amount of legal expenses sought by Defendants for the time period between December 1, 2017 through October 31, 2018?

6. The trial court issued an erroneous finding of fact that the expenses defense counsel incurred litigating this matter on Defendants' behalf between November 1, 2018 through December 10, 2018 were reasonably valued at $48,461.64.[5]

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[3] *See* CP 1234, 1547-49, 1577.

[4] CP 1577 (¶ 4).

[5] *Id.* (¶ 5).

Issue: Did the trial court adequately reduce the amount of legal expenses sought by Defendants for the time period between November 1, 2018 through December 10, 2018?

III. STATEMENT OF THE CASE

A. History of Rosen Supply Company

RSC is a plumbing supply company that does business throughout the Puget Sound area. CP 85–87. Four generations of Rosens have worked there. All six current shareholders are members of the Rosen family. Defendants are part of the second generation and Plaintiffs are part of the third, along with their cousin Devin Rosen (Harvey's son and Dianne's nephew). CP 1014. Because they have already reaped the benefits of working at the family business for decades, Defendants now only care about selling RSC and cashing out—regardless of whether their actions violate the company's shareholder voting rules and 1989 SPA.

Max and Sara Rosen, who were Defendants' parents and Plaintiffs' grandparents, started RSC in 1946 as a general partnership. CP 47–50. In 1978, RSC was incorporated by Plaintiffs' father and Defendants' brother, Byron Rosen (now deceased). CP 64–65. At that time there were five shareholders, each of whom was also a member of the board of directors: Max, Sara, Byron, Harvey, and Dianne. CP 70. Max and Sara gave their professional lives to RSC and planned for it to continue as a family

business for generations to come. CP 89. Not even Harvey disputes the fact that it "was [his] folks' wish" for RSC to "remain[] a company owned by the Rosens." CP 121 (166:21–25).

In line with the wishes of Max and Sara (the "First Generation"), Byron worked at RSC until he passed away in 1979. CP 324. Harvey, their son, has worked there since 1965, and Dianne, their daughter, worked at RSC periodically from 1959 through 2015. CP 108 (9:3–7), CP 55 (13:11–15:14). Byron, Harvey, and Dianne are known as the "Second Generation" at RSC. CP 1014.

Adam, David, and Matthew have also dedicated their entire professional lives to the family business. CP 129 (29:22–30:2) (Adam started in 1975); CP 148 (Matthew started in 1980); CP 165 (David started in 1983). Neither Matthew nor David has ever worked anywhere else. CP 174 (33:21–23); CP 181–82 (40:15–41:10); CP 164–65. Devin has likewise spent many years working at RSC. CP 112 (79:4–13). Adam, David, Matthew, and Devin are known as the "Third Generation" at RSC. CP 144. Several members of the "Fourth Generation" have also started working at RSC. CP 186 (107:19–108:15) (David's daughter and Devin's son). All parties to the litigation readily admit RSC is and always has been a family business. CP 113 (92:3–21); CP 57 (42:22–23, 44:3–5); CP 131 (109:19–110:19); CP 175 (78:16–79:9); CP 187 (113:12–24).

In 1989, to reaffirm RSC would remain a family business, Max and Sara established a Grandchildren's Stock Ownership Trust ("Grandchildren's Trust"). CP 89–98. The purpose of the Grandchildren's Trust was, in part, to "afford[] an opportunity to their grandchildren to obtain a stock ownership interest" in the "family owned Washington Corporation." CP 89. Harvey himself understood the Grandchildren's Trust was intended to keep the grandchildren involved with the company. CP 111 (73:2–15).

Today, RSC is a small family business owned by six people: Harvey, Dianne, Adam, David, Matt, and Devin. CP 130 (35:3–36:13); CP 183 (86:15–87:8). There is no dispute that Defendants own more than 50% of RSC's outstanding stock. CP 185 (102:23–103:1).

B. RSC's Governing Documents

1. Articles of Incorporation

RSC's Articles have not been amended since RSC incorporated in 1978. CP 478. In relevant part, the Articles provide that shareholder voting must occur on a per shareholder—as opposed to a per share—basis:

> Any contract, transaction, or act of the corporation or of the directors or of any officers of the corporation which shall be ratified ***by a majority or a quorum of the stockholders of the corporation*** at any annual meeting or special meeting called for such purpose, shall, insofar as permitted by law, be as valid and as binding as though ratified by every stockholder of the corporation.

CP 70 (Art. VIII § 4) (emphasis added). There is no reference in the Articles to shareholders voting "per share."

2. Bylaws

The Bylaws became effective in 1978 and reference the same "per shareholder" voting scheme. Under the Bylaws, a director may only be removed by "a majority vote of shareholders present at any annual or special shareholders' meeting at which a quorum is present." CP 192 (Art. III § 2). There are no references in the Bylaws to shareholders voting "per share." CP 109–10 (68:20–69:12, 72:11–25) (Harvey admitting he is not aware of any such reference). The language in the Articles and Bylaws make clear that the removal of board members, amendment of the Bylaws, and a sale of the company each require approval by a majority of RSC's shareholders on a per shareholder basis. This is consistent with undisputed admissions by Defendants, which the trial court disregarded, that RSC was started as a family business, has always been a family business, and was intended by its founders to remain a family business. *See, e.g.*, CP 121 (166:21-25).

Additionally, RSC's founders included specific language in the Bylaws that prevents a sale of RSC stock to a third party unless all of the remaining shareholders first decline to exercise certain rights of first refusal:

> No stock of this corporation shall be sold to any person other than the stockholders of this corporation until each of the remaining stockholders shall have been afforded the opportunity to purchase said stock at the price and under the terms and conditions evidenced as aforesaid, and shall have declined to do so . . . .

CP 198 (Art. XI, § (d)); *see also id* at 197–98 (Art. XI § (a)). In other words, the Bylaws require that a sale of RSC stock to any third party requires unanimous shareholder consent. CP 197–98 (Art. XI §§ (a), (d)). The only exception is set forth in subsection (f) which provides that "[a]ny 'Buy and Sell Agreement' entered into by all stockholders shall take precedence over Article XI." *Id.* at 198–99 (Art. XI § (f)).

3. 1989 Stock Purchase Agreement

RSC shareholders must also comply with the 1989 SPA, CP 459–67, which sets forth specific guidelines for the disposition of RSC stock and prohibits RSC shareholders from selling their shares other than to an existing RSC shareholder or to the company itself. The 1989 SPA was plainly drafted to help preserve RSC as a family business and, consistent with the Articles and Bylaws, to insulate the company from being sold to a third party except under very narrow circumstances. The 1989 SPA provides in relevant part:

- "Except as is provided for in this Agreement, no Stockholder of ROSEN SUPPLY CORPOARATION, INC., shall dispose of any of his or her stock in the Corporation . . . except in accordance with the provisions of this Stock Purchase Agreement." *Id.* at 460 (¶ 1).

- "[I]n the event that any stockholder should desire to dispose of any of his or her stock in the Corporation during his or her lifetime . . . the remaining Stockholders, or alternatively the Corporation, ***shall*** purchase all of the Stockholder's interest . . . ." *Id.* at 461 (¶ 5).

- "[U]pon the death of any Stockholder, the remaining Stockholders, or alternatively the Corporation, shall purchase . . . all of the decedent's stock . . . ." *Id.* (¶ 6).

- "In the event no stockholders elect to purchase, the Corporation ***shall be obligated*** to purchase the stock of the selling Shareholder or his or her estate." *Id.* at 462 (¶ 8) (emphasis added).

Defendants acknowledged in the proceedings below that the 1989 SPA prevents them from eviscerating RSC's status as family business, but tried to justify their actions on the basis that "[i]t's pretty hard to live under an agreement that was done 40 years ago." CP 120 (162:8–163:3). This, of course, is not a defense to violating RSC's corporate rules.

In addition to the requirement that RSC stock be sold to existing shareholders or RSC itself, the 1989 SPA contains explicit instructions about how shareholders must value the stock for purposes of a sale:

> The stock in the Corporation ***shall*** be valued for purposes of this Stock Purchase Agreement in accordance with the method of valuation set forth in the December 29, 1989, letter of Certified Public Accountant FRED AXE, a copy of which is attached to this Stock Purchase Agreement and by this reference incorporated herein.

CP 461–62 (¶ 7) (emphasis added); *see also id.* at 466–67 (Fred Axe valuation letter). The only exception is that in lieu of using the "Fred Axe" valuation method, "the Stockholders may redetermine the value for

purposes of this Stock Purchase Agreement ***by unanimous consent***." *Id.* at 462 (¶ 7) (emphasis added).

Not only does the 1989 SPA agreement dictate the valuation method, it also dictates the method and timing of payment:

> The purchasing stockholders and/or the Corporation ***agree to pay Fifteen (15%) percent of the purchase price in the year of the sale***, but in no event later than Ninety (90) days after the death of a Stockholder, and ***the balance of the purchase price in equal monthly payments*** commencing on the first day of the first month in the second year after the date of the decedent's death, or the date of sale, whichever is applicable. The unpaid balance of the purchase price shall be evidenced by a Promissory Note made by the purchasing stockholders or the Corporation . . . with interest at the rate of Nine (9%) percent per annum on the declining balance.

Id. at 462 (¶ 9) (emphasis added). Both Harvey and Dianne signed the 1989 SPA. *Id.* at 464. It can only be "altered, amended or terminated by a writing signed by the Corporation and all Stockholders." *Id.* at 463 (¶ 12). That has never happened.

C. Defendants Take Steps to Wrongfully Usurp Control and Improperly Sell the Family Business

1. Defendants Demand a Buyout in Violation of the 1989 SPA

Starting several years ago, Harvey and Dianne expressed their desire to exit RSC and turn the company over to the Third Generation. CP 133 (203:2–12); CP 114–15 (115:9–117:6). Accordingly, all shareholders began discussing possible succession plans. *Id.* On May 17, 2017,

Defendants sent the Third Generation an offer for the purchase of their shares in RSC. CP 235–46. But the value of the shares was not based on the Fred Axe valuation method, as the 1989 SPA required. Instead, Defendants relied on a third-party valuation to demand that over $5 million be paid to them "in cash at closing."[6] *Id.* at 237. Not only was this amount far higher than it would have been under the Fred Axe method (*compare id. with* CP 248), but by demanding all cash at closing Defendants ignored the fact that under the 1989 SPA a shareholder selling stock is only entitled to a 15% down payment at closing and payment of the balance of the sale price over time. CP 462 (¶ 9); *see supra* § III.B.3.

Notwithstanding the fact that Defendants were not entitled to the valuation they demanded and were not entitled to payment of the full amount in cash at closing, Adam, Matt, and David in good faith seriously considered whether they could afford to purchase and finance Defendants' shares at the price identified in the May 14 offer. CP 184 (98:1–99:18). Before Adam, Matt, and David had an opportunity to fully vet that option and respond, however, Defendants revoked their offer. CP 134 (254:5–14).

[6] This valuation is referred to in deposition testimony as the "Portside valuation." *See, e.g.*, CP 184 (98:1–8).

After revoking their offer, Defendants escalated the situation and had their lawyer threaten that Defendants would sell the business to a third party purchaser if there was not a "willingness [by the Third Generation] to consider inter-family acquisition on realistic terms." CP 219. Stated differently, if Adam, David, and Matthew did not acquiesce to Defendants' unreasonable and unlawful demand, they risked losing the family business to which they had devoted their entire professional careers. Defendants readily admitted they were already in discussions with two other national plumbing supply companies, Hajoca Corporation and Ferguson Enterprises, LLC, about a possible sale of RSC. CP 117–19 (138:9–14, 144:22–146:11) (Harvey admitting he signed a confidentiality agreement with Hajoca and started communicating with Ferguson about a sale in 2016 or 2017).

On November 9, 2017, Adam, David, and Matthew proposed to purchase Defendants' shares pursuant to the terms of the 1989 SPA. CP 248–49. Defendants refused to respond to that proposal. CP 121 (167:1–5); CP 56 (115:11–23); CP 256. In fact, Harvey never even read the offer. CP 122 (170:16–25). He simply decided the 1989 SPA did not apply to him:

> Q. Okay. So when you testified that things have changed since the Fred Axe letter, whether that's true or not, why does it matter in your mind? . . .

A. Just ***markets have changed.*** Positions have changed. Sales have changed.

Q. Why does that matter in your mind? . . .

A. ***It's pretty hard to live under an agreement that was done 40 years ago.***

Q. Why is it hard to live under an agreement that was done 40 years ago?

A. Every phase of our business, our own personal lives have changed.

CP 120 (162:8–163:3) (emphasis added). Dianne testified similarly:

Q. Does it matter to you whether the company stays in the Rosen family?

A. ***At this point in time, no.***

Q. Why not?

A. Because I think ***we have to take advantage of the market.*** And if we can't get fair market value, then so be it.

Q. Who's we?

A. Harvey and myself . . .

CP 59 (117:12–21) (emphasis added).

The 1989 SPA and other governing documents of RSC were drafted to be read together, and each of them reflects the founders' intent to retain RSC's character as a Rosen family business. The trial court concluded, despite this evidence, that shareholder votes must be counted on a per share basis, not per capita.

2. Defendants Call a Special Board and Shareholder Meeting

Intent on maximizing their own financial gain at the Third Generation's expense, on November 20, 2017, Defendants issued a "Notice of Special Joint Meeting of the Board of Directors and Shareholders of Rosen Supply Company, Inc." CP 201–17. The Notice called for a meeting to be held on December 1, 2017. *Id.* at 204. Defendants attached several Proposed Shareholder Resolutions to the Notice. CP 205. In those resolutions, Defendants sought to (i) remove David, Matthew, and Devin from the Board of Directors, (ii) amend and restate the bylaws to specify voting was "per share," (iii) set the number of RSC directors at three, and (iv) elect Harvey, Dianne, and Adam as the three board members. *Id.*

Adam, David, and Matthew objected to the Proposed Shareholder Resolutions and informed Defendants that no action could take place at the Special Meeting without the approval of a majority (i.e. at least four) of RSC's six shareholders. CP 256–57. Specifically, Adam, David, and Matthew expressed concern that "the shareholders' meeting appears to be an attempt by Defendants to disenfranchise half of the company's shareholders and to arrogate to themselves control of the business for their own personal benefit." *Id.* at 256. In addition, they expressed concern that Defendants' proposal to update the bylaws "would overthrow the voting

structure Max and Sara carefully conceived to counter-balance the respective interests of successive generations." *Id.* at 256–57.

Defendants disregarded the objections and proceeded to hold the Special Meeting on December 1, 2017. CP 262. At the meeting Adam, David, and Matthew again urged Defendants to follow RSC's "per shareholder" voting requirement, but Defendants forged ahead and declared (incorrectly) that the resolutions had passed because the holders of a majority of shares had voted in favor of them. CP 173 (7:17–8:3); CP 61 (126:12–22); CP 262–65. The real purpose behind Defendants' actions was to prepare the company for a third party sale of RSC so they could "take advantage of the market" over Plaintiffs' objections. CP 59 (117:12–21).

Prior to the December 1, 2017 Special Meeting, no shareholder vote at RSC had ever been formally documented. CP 625 (158:4–20). The only quasi-exception to that was a unanimous vote approving the buyout of Aaron Rosen in 2012 (Devin's brother and Adam's cousin). *Id.*; *see also* CP 620 (48:12–22). But even then, no one documented what method was used to tally the votes. CP 615 (113:6–14), 620 (48:12–22), 625 (158:4–20).

D. Proceedings in the Trial Court

In December 2017, Plaintiffs filed this lawsuit in Pierce County Superior Court, individually and derivatively on behalf of RSC. CP 1. They asserted four causes of action. CP 6–8. The first was a claim for breach of fiduciary duty based on the fact that Defendants put their own personal and financial interests above those of RSC and Plaintiffs. CP 6. The second claim was for anticipatory breach of the 1989 SPA based on Defendants' stated intention to sell their stock in violation of the terms of that agreement. CP 7. Third, Plaintiffs requested declaratory judgment that (1) the Proposed Shareholder Resolutions were not lawfully approved; (2) Defendants violated the RSC governing documents and their duties to RSC and Plaintiffs by purporting to enacted the Proposed Shareholder Resolutions; and (3) the Board's purported enactment of the Proposed Shareholder Resolutions was *ultra vires* and/or in violation of the Board members' duties and therefore unenforceable, null, and void. CP 7–8. Finally, Plaintiffs asserted a cause of action for injunctive relief, "permanently enjoin[ing] RSC from enforcing or otherwise abiding by the Proposed Shareholder Resolutions and order[ing] the Board and shareholders of RSC to follow RSC's governing rules, procedures, and principles in the future." CP 8.

Defendants filed three counterclaims. CP 276, 284. In the first for declaratory relief and damages, Defendants sought the following declarations: (1) the statutory presumptions of "one share, one vote" and cumulative voting as to the election and removal of directors apply to RSC; (2) the shareholder votes on December 1, 2017 were valid and binding and the shareholders validly adopted the Amended and Restated Bylaws; (3) there is no limitation on the rights of RSC to sell substantially all of RSC's assets, cease doing business entirely, liquidate RSC, or exercise such other rights as would be available to RSC under Washington law; (4) Defendants did not violate the 1989 SPA; and (5) Defendants are entitled to indemnification and advancement of defense costs. CP 289–90. They also claimed Plaintiffs "maliciously filed" a "frivolous lawsuit in bad faith, for the sole and improper purpose of stymieing RSC's rights to sell its assets or enter into a merger or combination with a third party" and in doing so caused Defendants damages. CP 290 (¶¶ 29–30).

Defendants' second counterclaim was for permanent injunctive relief enjoining Adam from pursuing the lawsuit and interfering with a sale or liquidation of RSC's assets or a merger or combination with a third party. CP 290–91. In their third counterclaim, Defendants alleged Adam breached his fiduciary duties by "filing this lawsuit for the sole purpose of

interfering with RSC's reserved rights under Section 16 of the 1989 SPA." CP 291–92.

In the first of two sets of cross-motions for partial summary judgment, the parties asked the trial court to determine, among other things, (1) whether RSC's voting regime was per capita or "one share, one vote"; (2) whether Section 16 of the 1989 SPA limits RSC's right to sell assets, cease doing business entirely, or liquidate RSC; and (3) whether the actions taken at the December 1, 2017 Special Joint Meeting were valid and binding. CP 13–42, 296–321. In disregard of the undisputed evidence, the trial court denied Plaintiffs' motion, granted Defendants' motion, and issued declaratory judgment in favor of Defendants on the above three issues. CP 648–50, 651–53.

After that ruling, the only remaining issues in the case were whether Adam's claims were frivolous, and whether and to what extent Defendants were entitled to indemnification. The parties' submitted a second set of dispositive cross-motions on those issues. In response, the trial court ruled that Defendants were entitled to mandatory indemnification under RCW 23B.08.520, rejected Defendants' argument that Adam's claims were frivolous, and denied the remainder of Defendants' counterclaims. CP 1074–77.

IV. ARGUMENT

The trial court erred in granting summary judgment for Defendants and denying summary judgment on Plaintiffs' cross-motion on the issue of shareholder voting. The plain language of the Articles provides for shareholder voting on a per shareholder basis, and even if the language in the Articles was ambiguous, the extrinsic evidence is all consistent with the fact that RSC's founders established a per shareholder voting regime.

A. Standard of Review

The granting of summary judgment is reviewed de novo. *Wagg v. Estate of Dunham*, 146 Wn.2d 63, 67, 42 P.3d 968 (2002); *Stokes v. Bally's Pacwest, Inc.*, 113 Wn. App. 442, 444, 54 P.3d 161 (2002). Where a trial court decides a declaratory judgment action on its merits, the appellate court may "determine the propriety of the lower court's grant or denial of declaratory relief." *Wash. Fed'n of State Employees v. State*, 107 Wn. App. 241, 244, 26 P.3d 1003 (2001). When a written contract has only one meaning and material facts are undisputed, it is proper on appeal to reverse a denial of summary judgment and direct the entry of summary judgment for the opposing party. *See Stokes*, 113 Wn. App. at 450.

The Court reviews a trial court's initial determination of the legal basis for an award of attorney's fees de novo. *Gander v. Yeager*, 167 Wn. App. 638, 647, 282 P.3d 1100 (2012). The Court reviews a "discretionary

decision to award or deny attorney fees and the reasonableness of any attorney fee award for an abuse of discretion." *Id.* A trial court abuses its discretion when its decision is "manifestly unreasonable, or exercised on untenable grounds, or for untenable reasons." *Tribble v. Allstate Property & Cas. Ins. Co.*, 134 Wn. App. 163, 170, 139 P.3d 373 (2006).

B. The Trial Court Erred by Denying Plaintiffs' Request for Declaratory Relief that RSC Defines Shareholder Voting as Per Shareholder, Granting Defendants' Request for Declaratory Relief to the Contrary, and Granting Defendants Additional Relief on that Basis

1. Corporations Have the Right to Define the Rules of Shareholder Voting and the Plain Language of RSC's Articles Establish Voting on a Per Shareholder Basis

Washington law is clear that articles of incorporation must be interpreted like any other contract. *Walden Inv. Group v. Pier 67, Inc.*, 29 Wn. App. 28, 30–31 (1981) ("The articles of incorporation represent a contract between the corporation and its shareholders and should be interpreted in accordance with accepted rules of contract construction."); Corporate founders are free to define the rules of shareholder voting in the articles of incorporation. RCW 23B.07.210(1). The Washington Business Corporation Act specifically allows a corporation to depart from the statutory presumption of "one share one vote" where "the articles of

incorporation provide otherwise." *Id.*[7]

As they were expressly permitted to do under RCW 23B.07.020(1), RSC's founders "provided otherwise" and elected to define shareholder voting on a per shareholder basis:

> Any contract, transaction, or act of the corporation or of the directors or of any officers of the corporation which shall be ratified by ***a majority or a quorum of the stockholders*** of the corporation at any annual meeting or any special meeting called for such purpose, shall insofar as permitted by law, be as valid and as binding as though ratified by every stockholder of the corporation.

CP 70 (Art. VIII, § 4) (emphasis added). There is nothing ambiguous about the phrase "a majority or quorum of the stockholders." It means precisely what it says. The clear and indisputable fact is that a *stockholder* is not the same as *stock*. When Article VIII § 4 requires that "a majority or a quorum of the stockholders" approve a corporate action before the action is "valid" or "binding" on RSC, there can be no doubt that it is referring to a majority of the *people* who own stock in the company, not the stock itself. Basic principles of contract interpretation do not permit any other result. This conclusion is bolstered by the fact that the Articles make no reference to voting by share or a majority of the outstanding shares. Nor do the Bylaws. *See supra* §§ III.B.

[7] Neither the Corporation Act nor any case law Defendants identified below imposes a heightened burden or any other special requirement on a party seeking to establish that articles of incorporation "provide otherwise."

The fact that the "majority or a quorum of the stockholders" language appears in a section discussing ratification does not nullify its application to all voting. "Ratification" means "adoption or enactment, esp. where the act is the last in a series of necessary steps or consents." BLACK'S LAW DICTIONARY (10th ed. 2014). Thus, the effect of Article VIII § 4 is that RSC's shareholders must approve corporate action—i.e., vote on it—on a per shareholder basis. The Court's analysis should begin and end with Article VIII § 4, which plainly mandates shareholder voting on a per *shareholder* basis.

This conclusion is consistent with case law from other states, as well as preeminent treatises on Washington corporate law—including those cited by Defendants in the proceeding below. *See In re Westech Capital Corp.*, CIV.A 8845-VCN, 2014 WL 221162, at *3 (Del. Ch. May 29, 2014); *Sagusa, Inc. v. Magellan Petroleum Corp.*, CIV.A. 12,977, 1993 WL 512487, at *1 (Del. Ch. Dec. 1, 1993), *aff'd*, 650 A.2d 1306 (Del. 1994); 5 Fletcher Cyc. Corp. § 2020 (2017); 18A Am. Jur. 2d Corporations § 841. Indeed, in *Sagusa*, the Delaware court explicitly rejected a similar challenge to a per capita voting requirement, which stated that any matter must be approved "by a majority of the stockholders present." Additionally, both treatises cited above recognize that founders can have a provision "to the contrary" mandating voting per capita, not per

share. Even the cases cited in those treatises reaffirm that where the articles of incorporation "provide otherwise," the term "stockholders" means exactly what it says—i.e., people. *See, e.g.*, *Seward v. Am. Hardware Co.*, 161 Va. 610, 634–35, 171 S.E. 650, 661 (1933). In *Seward*, the court specifically recognized that even though voting per share seemed reasonable, "there is authority to the contrary." *Id.* at 636 (citing *Smith v. Iron Mountain Tunnel Co.*, 46 Mont. 13, 125 Pac. 649, 651 (1912)). And in *Smith*, the court agreed that stockholders are different than stock or shares and to assume that the word "stockholders" actually means stock is improper:

> [T]he conclusion seems inevitable that in employing the term 'stockholders,' . . . the Legislature referred to the ***individuals*** who are the owners of shares of stock, and not to the shares themselves, and that, when the Legislature declared that the nonassessable stock of a corporation can be made assessable 'with the consent of three–fourths of its stockholders,' it meant just what it said. To declare that the use of the word 'stockholders' is a mere inadvertence is to impeach the intelligence of the legislators.

Id. at 651. Per shareholder voting may be unusual, but that is the regime by which the RSC founders chose to abide. And it makes sense, given that RSC is a small family business, not a large corporation with thousands of shareholders. *See supra* § III.A. Indeed, the 1989 SPA and Defendants' own testimony make that clear.

Defendants relied below almost exclusively on a case that is nearly 120 years old to support their argument that the Articles are silent on the issue of shareholder voting and therefore the statutory presumption of one share, one vote applies. *State ex rel. Mitchell v. Horan*, 22 Wash. 197, 200, 60 P. 135 (1900). First, none of the key facts presented here—e.g., undisputed evidence of the founders' intent and admissions like those made by Defendants—were present in *Horan.* Moreover, *Horan* does not stand for the proposition that Defendants claim—that the "ordinary, usual, and popular meaning" or a majority of shareholders actually means the opposite of what it says (i.e. a majority of shares). In *Horan*, the court was interpreting a statute, not articles of incorporation or any other contract. And the statutory scheme at issue in *Horan* made explicit reference to voting by share. *Horan*, 22 Wash. at 200. Here, in stark contrast, the Articles of RSC do not require any voting by share and refer only to voting by shareholder to make a corporate action "valid" and "binding" on RSC. Interpreting a statutory scheme with conflicting provisions that require harmonizing is different than simply reading and enforcing the plain language of the Articles.

Moreover, *Horan* has been cited a total of six times in 120 years, only one of those six cases is Washington case, and the only Washington case that cites to *Horan* does not even cite to it for the shareholder voting

issue. If *Horan* enunciated this bedrock principle of the ordinary meaning of "stockholder," one would certainly expect to see it cited at least once for that proposition. The fact that it has never been cited in Washington for that reason speaks volumes.

Reliance on *Horan* is also inconsistent with significantly more recent caselaw on contract interpretation that has time and again been applied to interpret corporate documents, including articles of incorporation. *See supra.* What is more, *Horan* was decided long before the legislature enacted the controlling statute (RCW 23B.07.210) in 1989. Even if *Horan* did stand for the proposition that Defendants claim, what the legislature "had in contemplation" over 100 years ago simply is not relevant to the dispute before this Court.

Because voting at RSC is per shareholder, the removal of board members, the amendment of the Bylaws, and the sale of the company all require approval by a majority of RSC's shareholders. CP 192 (Bylaws Art. III § 2) (removal of board members); *Id.* at 197 (Art. IX) (Bylaws amendment of Bylaws); CP 70 (Articles Art. IIII § 4) (sale of RSC). Since only 50% of RSC's shareholders approved the actions at the Special Meeting in December 2017 (Harvey, Dianne, and Devin), those actions were invalid and not binding on the corporation. The trial court erred by granting summary judgment to the contrary.

2. Undisputed Extrinsic Evidence Is Consistent With Per Shareholder Voting

When interpreting a contract, extrinsic evidence can be used "'to determine the meaning of specific words and terms used." *Viking Bank v. Firgrove Commons 3, LLC*, 183 Wn. App. 706, 713, 334 P.3d 116 (2014). Here, undisputed extrinsic evidence is consistent with per shareholder voting.

a. 1978 Bylaws

Significantly, the 1978 Bylaws—which were drafted at the same time as the Articles—are consistent with per shareholder voting: "Any director or all directors, may be removed by a ***majority vote of shareholders*** present . . ." CP 192 (Art. III § 2) (emphasis added). In addition, the Bylaws specifically prevent a sale of RSC stock to any third party unless ***all*** of the existing RSC shareholders decline to exercise rights of first refusal first. CP 197–98 (Art. XI §§ a, d). And the only exception to that is if ***all*** shareholders agree to enter into a "Buy and Sell Agreement." *Id.* at 199 (Art. XI § f). There is no explanation for these strict provisions regarding a sale of RSC stock except to protect RSC as a family business and to prevent the type of misconduct Defendants are engaging in here.[8] Further, there is no language in the Bylaws even

[8] Defendants did not directly address this argument below, except to state that this language does not address *how* the shareholders count votes and to argue

suggesting that shareholder voting is properly conducted on a per share basis instead. And even if there was, the language of the Articles would still govern. RCW 23B.02.060(4) (bylaws cannot conflict with the articles of incorporation).

Notably, by proposing updated Bylaws in December 2017 that include a provision stating that every shareholder shall have the right "to one vote for every share standing in the shareholder's name on the books of the corporation" Defendants conceded that the existing Bylaws did *not* contain that requirement. CP 209 (Art. 2 § 10). This was a dispositive admission that RSC's shareholders have always been bound to vote on a per shareholder basis.[9]

b. 1989 SPA

The same conclusion must be reached even if one looks to the 1989 SPA. Like the Articles, the 1989 SPA also refers to voting by "stockholder." CP 463 (p. 5, § 12). The 1989 SPA does not allow Defendants to sell RSC and/or its assets without approval by a majority of RSC's shareholders. Instead, it explicitly directs that existing shareholders

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that the Bylaws cannot establish a shareholder voting regime that conflicts with the Articles. CP 316. But the plain language of that provision demonstrates that shareholder voting is "per shareholder" and that is consistent with the language in the Articles. *See supra* §§ III.B.1, IV.B.1.

[9] Defendants' post-hoc justification that changing the language to add "per share" was merely part of the "updating" process because the "Bylaws had not been updated since RSC was formed in 1978" does not make sense. CP 493–95.

or the company itself buy the stock of shareholders who wish to sell. *See supra* § III.B.3. Why would the 1989 SPA contain a prohibition preventing shareholders from selling their shares to outsiders if the founders intended for the holders of a majority of shares to have unfettered discretion to sell RSC to a third party at any time? They would not.

Nor does Section 16 of the 1989 SPA provide Defendants with authority to disregard the remainder of the 1989 SPA. Section 16 states: "Nothing contained in this Agreement shall limit the rights of the Corporation from selling substantially all the Corporation's assets, ceas[ing] doing business entirely, liquidat[ing] the Corporation, or carry[ing] out such other rights as would be available to it under the corporate law of the State of Washington." CP 463–64. Under Washington corporate law, the sale of "all, or substantially all, of [a corporation's] property and assets" requires approval by the Board ***and*** all of RSC's shareholders. RCW 23B.12.020(1). Section 16 does not change that. Section 16 does not allow RSC to sell to a third party without majority approval. This includes an asset sale. In other words, Section 16 stands for the unremarkable proposition that the company may undertake certain actions, including a sale of its assets, so long as such actions are consistent with Washington law. It simply clarifies that restrictions on how economic interests may be transferred shall not interfere with how the shareholders

will determine if, how, or when RSC may be sold. That determination depends upon the Articles. Selling RSC without approval by a majority of RSC's shareholders would be unlawful, and nothing in Section 16 suggests otherwise. That is true regardless of whether RSC is going to be sold through an asset sale, merger, or share exchange.

Defendants' brazen disregard for the 1989 SPA and other governing documents that provide RSC should remain in the Rosen family undermines the notion that a minority of shareholders can lawfully take control of the company and sell it to a third party. If that were the case, Defendants would long ago have amended the SPA to their liking. But they did not—because they knew they lacked the power to do so. Instead, they simply pretended the SPA does not mean what it says, and that they are empowered to dispose of RSC in any manner they see fit. As Harvey testified, he considered it "pretty hard to live under" the 1989 SPA. CP 120 (162:8–163:3). At a minimum, such evidence should have led the trial court to find a question of material fact on the issue of shareholder voting.

c. Other Evidence that Post-Dates Incorporation

None of the other extrinsic evidence to which Defendants pointed in their summary judgment briefing, all of which post-dates the drafting of the Articles by many years, supports Defendants' position on shareholder voting. For example, recent email exchanges between Defendants'

personal lawyer and Plaintiffs had nothing to do with the narrow issue before the court. Similarly, whether Adam or his brothers raised the issue of shareholder voting before December 1, 2017, or what any of them think about that legal issue, does not shed any light on what the drafting parties intended.

For the same reason, the language in the Grandchildren's Trust, which is an entirely separate entity from RSC and was created ten years after the Articles, is irrelevant to the analysis. Certainly, it says nothing about how shareholders are supposed to vote. And, even if it did, it could not trump the Articles. RCW 23B.02.060(4) (bylaws cannot conflict with the articles of incorporation). If anything, the fact that the Grandchildren's Trust speaks about "voting by shares" demonstrates that Max and Sara knew how to use that language if they wanted to do so. *See Markel Am. Ins. Co. v. Dagmar's Marina, L.L.C.*, 139 Wn. App. 469, 480, 161 P.3d 1029 (2007) ("When . . . the drafter of an agreement employs different terms instead of parallel terminology, the presumption has to be that the change in usage was purposeful and reflects different and not parallel meaning.") (citing *Robin v. Sun Oil Co.*, 548 F.2d 554, 558 (5th Cir. 1977)). Ultimately, what matters is what the Articles say. Nothing that any of the parties has said or thinks about shareholder voting determines the outcome of this matter.

3. No Authority Allows the Trial Court to Disregard the Plain Language of the Articles

Not a single one of the cases Defendants cited in the trial court involved a court disregarding the plain language of articles of incorporation. *See supra* § IV.B.1. Moreover, a per shareholder voting regime is also permitted by the Model Business Corporations Act ("MBCA"), on which Washington's corporate code is based. Model Business Corporations Act – Comments (2007) § 7.21 (CP 272–73). Defendants argued below that under the MBCA "companies will ***always*** vote per share." CP 490–91 (emphasis added). But that interpretation ignores the plain language of the controlling Washington statute specifically allowing companies to do just that. RCW 23B.07.210(1). If the law was truly that corporations could not under any circumstance vote per shareholder, the legislature could have and presumably would have simply said so. It did not. Defendants' interpretation of the MBCA as limiting how a corporation could provide an alternative voting regimen failed to recognize that the commentary does not provide an exhaustive list. Even if it did, that would not be binding.

4. This Court Should Reverse the Trial Court's Rulings That Flow from Its Erroneous Conclusion Regarding Shareholder Voting

As a result of its erroneous conclusion that RSC shareholders vote on a per share basis, the trial court issued a number of additional rulings that should be reversed by this Court, including:

- "RSC validly updated its Bylaws at RSC's December 1, 2017 Special Joint Meeting of the Shareholders and Board members of RSC and those new Bylaws remain in effect at the Company." CP 648-50; *see also* CP 651–53 (denying Plaintiffs' motion for partial summary judgment on the same issue).
- "RSC's current Board of Directors is comprised of Harvey Rosen, Dianne Arensberg, Devin Rosen, and Adam Rosen pursuant to the cumulative voting procedure conducted at RSC's December 1, 2017 Special Joint Meeting of the Shareholders and Board members of RSC." CP 648-50; CP 651–53 (denying Plaintiffs' motion for partial summary judgment on the same issue).
- "Plaintiffs' claims with respect to the enforceability of the actions taken at the December 1, 2017 Special Joint Meeting of the Shareholders and Board members of RSC are hereby DISMISSED WITH PREJUDICE." CP 648-50; CP 651–53 (denying Plaintiffs' motion for partial summary judgment on the same issue).

The trial court also denied Plaintiffs' motion for partial summary judgment on Plaintiffs' claim for injunctive relief, which sought rulings as a matter of law that "Defendants are permanently enjoined from acting in a manner inconsistent" with the rulings Plaintiffs sought on shareholder voting, and that Defendants are likewise enjoined from selling RSC in a manner inconsistent with those same rulings. CP 651–53. This, too, was

error, and the Court should reverse and order the judgment be entered in Plaintiffs' favor on each of the foregoing issues.

C. Defendants Were Not Entitled to Mandatory Indemnification

1. Defendants Were Sued Because They Exceeded Their Authority as Shareholders, Not "Because of Being" Directors, and Were Therefore Not Entitled to Mandatory Indemnification

In response to Defendants' second dispositive motion, the trial court erroneously concluded that they were entitled to mandatory indemnification under the Corporations Act. CP 1074-77; *see also* RCW 23B.08.520; RCW 23B.08.550. Statutory indemnification is only permissible in limited circumstances, however, and only when each of the statutory elements is satisfied. Here, they were not.

RCW 23B.08.520 provides in relevant part: "Unless limited by its articles of incorporation, a corporation shall indemnify a director who was wholly successful, on the merits or otherwise, in the defense of any proceeding to which the director was a party ***because of being a director*** of the corporation against reasonable expenses incurred by the director in connection with the proceeding" (emphasis added). The underlying principle is that if a person is only sued by virtue of being a corporate director, and not as the result of alleged wrongdoing, then the corporation should pay the expenses of the litigation. In other words, if a company is sued and a director is named only by virtue of their status as a director,

then it makes sense, assuming the other statutory requirements are met, for the director to be indemnified.

Defendants, however, were not sued by reason of the fact that they were directors or officers of RSC. They were sued because, Plaintiffs alleged, they pursued shareholder resolutions "for improper purposes, including their desire to avoid their obligations under the 1989 SPA and to sell RSC and/or its assets to a third party purchaser over Defendants' objections." CP 5. Further, Plaintiffs alleged, "Defendants' actions and omissions—in failing to follow RSC's governing rules, procedures, and principles—are intended to, among other things, advance Defendants' plan to sell their stock in violation of the 1989 SPA." *Id.* at (¶ 36). Put differently, the misconduct Plaintiffs alleged were actions that Defendants undertook ***as shareholders*** to advance their personal financial interest in selling RSC to a third party—as opposed to actions undertaken on behalf of the corporation. Simply because the trial court concluded (erroneously) that Defendants vote on a per share basis does not mean that Defendants were acting on behalf of the corporation when they pursued their proposed shareholder resolutions. To the contrary, Defendants plainly pursued the proposed resolutions to advance their personal interest in taking "advantage of the market." CP 59 (117:12-21).

Accepting Defendants' broad interpretation of the mandatory indemnification statute would violate the basic rule of statutory construction requiring courts to give effect to "each word." *See City of Kent v. Lamb*, 1 Wn. App. 737, 740, 463 P.2d 661 (1969). Statutes must be construed "so that *no part* is superfluous." *See Amresco Independence Funding, Inc. v. SPS Properties, LLC*, 129 Wn. App. 532, 536, 119 P.3d 884 (2005) (emphasis added). Had the Washington legislature intended for the mandatory indemnification statute to be triggered each and every time a director is sued—regardless of the allegations—it would have provided for that. Instead, the legislature limited mandatory indemnification to those circumstances where "the director was a party because of being a director of the corporation . . ." RCW 23B.08.520. That restriction on the scope of mandatory indemnification necessarily excludes situations, like here, where the director is named as a party because of alleged self-dealing—not "because of being a director."

2. Defendants Mischaracterize Plaintiffs' Allegations

In an effort to force this case into the narrow ambit of mandatory indemnification, Defendants mischaracterized Plaintiffs' "basic allegation" as limited to whether "Harvey and Dianne took actions beyond their legal authority as members of RSC's Board of Directors." CP 781. But the gravamen of Plaintiffs' complaint was that Defendants had

exceeded their authority as shareholders by purporting to control the company simply because they own a majority of outstanding stock. Indeed, Defendants have never defended their position on shareholder voting—the issue that lies at the heart of this case—by virtue of their status as directors. And even Defendants' framing of the issue failed to trigger mandatory indemnification, because the "actions" that Defendants took were designed to promote their own interests, not those of RSC. Regardless of whether this Court agrees with the trial court's conclusion that voting occurs on a per share basis, that does not alter the substance of Plaintiffs' "basic allegation," or otherwise affect the question of indemnification.

Nor were Defendants entitled to mandatory indemnification simply by virtue of the lawsuit having been filed derivatively. Defendants cited no authority below for that proposition, and Plaintiffs are aware of none. Defendants likewise suggested that they were entitled to mandatory indemnification because there are procedural hurdles to satisfy the permissive indemnification requirements under RCW 23B.08.550. CP 782. But just because obtaining permissive indemnification presents procedural prerequisites (which Defendants admittedly failed to satisfy) does not mean Defendants were instead entitled to mandatory indemnification under RCW 23B.08.540.

In addition, it was improper for the trial court to order RSC, a mere nominal defendant to these proceeding that was unrepresented by counsel (as is typical in derivative actions), to indemnify Defendants. *See, e.g., Loveridge v. Fred Meyer, Inc.*, 72 Wn. App. 720, 725, 864 P.2d 417, 419 (1993) ("In general, even if a judgment purports to affect the rights of third parties, those parties are not bound by the judgment unless their interests were adequately represented by a party to the litigation.") (citing *Martin v. Wilks*, 490 U.S. 755 (1989)); *see also City of Seattle v. Fontanilla*, 128 Wn.2d 492, 502–03, 909 P.2d 1294 (1996). Defendants did not sue on behalf of or assert a claim against RSC for indemnification; indeed, no claims were asserted against RSC at all. Defendants' counterclaims were all directed at the individual Plaintiffs themselves. *See* CP 284.

D. Even if This Court Concludes Adam, Matthew, and David Are Not Entitled to Summary Judgment, Reversal is Still Warranted

This Court should reverse, even it is declines to order summary judgment in Plaintiffs' favor, because it was not possible for the trial court to rule in favor of Defendants without improperly drawing inferences against Plaintiffs and resolving factual issues.

The interpretation of an unambiguous contract is a question of law. *Stranberg v. Lasz*, 115 Wn. App. 396, 402, 63 P.3d 809 (2003). But "when

a court relies on inferences drawn from extrinsic evidence, interpretation of a contract is a question of fact." *Viking Bank*, 183 Wn. App. at 711. Notably, even where facts are not in dispute, if the facts are subject to more than one reasonable inference, summary judgment is not proper:

> Importantly, even if the basic facts are not in dispute, if the facts are subject to reasonable conflicting inferences, summary judgment is improper. Indeed, [s]ummary judgment procedures are not designed to resolve inferential disputes. It seems obvious that in situations where, though evidentiary facts are not in dispute, different inferences may be drawn therefrom as to ultimate facts such as intent, ... a summary judgment would not be warranted.

Kelley v. Tonda, 198 Wn. App. 303, 311, 393 P.3d 824 (2017) (internal citations omitted).

Plaintiffs' request for declaratory judgment was based on the plain language of the Articles. Accordingly, it would be proper to grant summary judgment in Plaintiffs' favor as a matter of law. *Stranberg*, 115 Wn. App. at 402. Defendants' request, however, was based on extrinsic evidence, including the 1989 SPA, the Grandchildren's Trust, and/or recent correspondence among the shareholders, among other things. *See supra* § IV.B.2. Defendants admit there is no language in the Articles suggesting shareholder voting is defined as per share. CP 312. Thus, to reach the conclusion that shareholder voting is per share, the trial court must have looked to extrinsic evidence to assist with its interpretation of

the language in the Articles referencing approval by a majority of stockholders, and must have drawn inferences from that extrinsic evidence. *See supra* § IV.B.1.

Viewing the evidence and drawing inferences in Plaintiffs' favor as the non-moving parties, there are reasonable conflicting inferences that can be drawn that preclude summary judgment for Defendants. By drawing inferences in Defendants' favor and granting summary judgment where Defendants' position required the court to draw inferences from extrinsic evidence so, the trial court erred.

E. Defendants' Fee Award Was Unreasonable and Should Have Been Denied Outright or More Substantially Reduced

Plaintiffs' claims involved a narrow issue that was resolved on summary judgment. Yet Defendants petitioned the trial court for an award of legal expenses in excess of $600,000. CP 1233-1235; CP 1515-18. Although the trial court reduced that to $469,387.24 (plus a subsequent award of $18,531.50 in expenses pursuing indemnification[10]), the amount was still unreasonable and excessive.

According to defense counsel's invoices, no fewer than nine partners (and a total of 21 different timekeepers) worked on the case, a number that is impossible to reconcile to the volume of work required.

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[10] *See* CP 1547-49.

Defense counsels' invoices were replete with examples of extraordinary overbilling. By way of example, and not limitation:

- Defendants claimed approximately $50,000 in fees for "an initial analysis of the claims, answering the complaint, and creating a strategy for litigation" (emphasis added). This is impossible to defend. The complaint is only nine pages long and asserts just four claims. The case is based on a single, legal dispute; i.e., whether RSC shareholders vote per shareholder or per share. CP 1096.

- A partner billing at $510 per hour spent approximately 50 hours drafting a motion to strike—an inconsequential effort that the trial court largely rejected. CP 1094–1181.

- Partner William Lin (a corporate lawyer) spent just shy of 30 hours at $560/hour (totaling approximately $16,800) performing legal research and/or drafting memorandum about his research. Such work, to the extent it was necessary at all, should reasonably have been performed by an associate. CP 1100.

- Apart from the enormous number of hours incurred by associates on Defendant's Motion for Partial Summary Judgment, three separate partners billed over 50 hours on that same motion. The partner fees alone totaled approximately $35,500. Overall, defense counsel charged approximately $150,000 for work on one round of dispositive motions practice—an extraordinary and unreasonable figure. CP 1094–1181.

To make matters worse, Defendants made no effort to segregate the expenses they incurred in defending against Plaintiffs' claims, which were theoretically subject to indemnification, from expenses incurred in prosecuting their counterclaims, the majority of which were not.

The parties' litigated the fee petition, and the trial court reduced the award significantly. CP 1233–35. But given how egregious the petition was, it should either have been denied outright or reduced further.

1. Defendants Failed to Segregate Recoverable Expenses

It was Defendants' burden to segregate recoverable legal expenses from those that are not recoverable. *Loeffelholz v. Citizens for Leaders with Ethics and Accountability Now (C.L.E.A.N.)*, 119 Wn. App. 665, 690, 82 P.3d 1199 (2004) (citing cases) ("The burden of segregating, like the burden of showing reasonableness overall, rests on the one claiming such fees."); *see also Hume v. Am. Disposal Co.*, 124 Wn.2d 656, 672, 880 P.2d 988 (1994) ("If, as in this case, an attorney fees recovery is authorized for only some of the claims, the attorney fees award must properly reflect a segregation of the time spent on issues for which attorney fees are authorized from time spent on other issues."). If a party fails or refuses to segregate legal expenses, the trial court should deny them entirely, or at the very least "independently decide what represents a reasonable amount of attorney fees." *Id.* As the California Supreme Court held in *Serrano v. Unruh*, 32 Cal.3d. 621, 635, 652 P.2d 985 (1982):

> [P]revailing parties [should not be allowed] to force their opponents to a Hobson's choice of acceding to exorbitant fee demands or incurring further expense by voicing legitimate objections. Prevailing parties are compensated for hours reasonably spent on fee-related issues. A fee request that appears unreasonably inflated is a special

> circumstance permitting the trial court to reduce the award or deny one altogether. If the Court were required to award a reasonable fee when an outrageously unreasonable one has been asked for, claimants would be encouraged to make unreasonable demands, knowing that the only unfavorable consequence of such misconduct would be reduction of their fee to what they should have asked in the first place. To discourage such greed, a severer reaction is needful.

(Internal quotations, citations, and alterations omitted).

Under the plain language of the mandatory indemnification statute, Defendants were only entitled to fees incurred "in the ***defense*** of any proceeding to which [they were parties] because of being a director of the corporation . . ." RCW 23B.08.520 (emphasis added). The same conclusion follows from the plain language of the Amended Bylaws: "Each person who was or is made a party . . . by reason of the fact that he or she is or was a director or officer of the corporation . . . shall be indemnified . . . to the full extent permitted by the Washington Business Corporation Act . . ." CP 808–09. By failing to segregate such expenses from those incurred in defending against Plaintiffs' claims—some of which were theoretically recoverable—it was impossible for the court to distinguish the two categories from each other. Thus the petition should have been denied in its entirety. *Loeffelholz*, 119 Wn. App. at 692. At a minimum, Defendants' requested expenses should have been reduced to account for the significant portion of time spent on tasks relating to the

prosecution of their counterclaims, as opposed to defending against Plaintiffs' claims.

Defendants' fee petition should also been reduced further to account for the various legal theories and motions they pursued without success. *See SAK & Assocs., Inc. v. Ferguson Constr., Inc.*, 189 Wn. App. 405, 419–20, 357 P.3d 671 (2015) (Washington courts disallow the recovery of fees to a prevailing party for "hours pertaining to unsuccessful theories or claims"); *Chuong Van Pham v. City of Seattle, Seattle City Light*, 159 Wn.2d 527, 538–40, 151 P.3d 976 (2007) (deduction from fee award proper for hours spent on unsuccessful claims and unsuccessful motions). Here, the indemnification statute precludes Defendants from recovering any expenses incurred in prosecuting the substantial majority of their counterclaims, including, at a minimum: (1) the majority of their first counterclaim for declaratory relief; (2) their second counterclaim for injunctive relief; and (3) their third counterclaim for breach of fiduciary duty.

2. The Amount Requested Was Unreasonable

This case was active in the trial court for less than one year, was focused almost entirely on one narrow issue, involved virtually no non-party discovery, and did not go to trial. Defendants' petition for an award of over $600,000 was plainly excessive and unreasonable. Additionally,

Defendants' invoices were rife with duplicative entries that should have been deducted from the overall fee award, including an overall reduction to account for overstaffing. Defendants sought recovery for work performed by more than 20 different timekeepers—15 different attorneys (nine of whom are partners), three paralegals, and three librarians. CP 1094–1181. This was unreasonable on its face.

In contrast to the panoply of names on Defendants' invoices, Plaintiffs' legal team consisted primarily of one partner and one associate, and included minimal oversight by a second partner and periodic assistance by one paralegal.[11] While it may have been Defendants' prerogative to have 21 people assist on their case, RSC was "not required to pay for a Cadillac approach to [this] Chevrolet case." *Berryman v. Metcalf*, 177 Wn. App. 644, 662, 312 P.3d 745 (2013).

Likewise, Defendants were not entitled to recover for the unnecessary efforts they spent litigating this case. *Berryman*, 177 Wn. App. at 663 (trial court must take into consideration excessive time incurred on tasks). In addition to overstaffing, this includes, among other things, fees spent on unnecessary research, unnecessary strategizing, unnecessary internal projects and drafting of memoranda, and ministerial

[11] *See* CP 1454–81.

and administrative tasks. *See, e.g., Emerick v. Cardiac Study Center, Inc., P.S.*, 189 Wn. App. 711, 708, 357 P.3d 696 (2015).

Nor were Defendants entitled to recover fees that were "block-billed." Block billing is disfavored in Washington because it raises the specter of overbilling through the inclusion of unproductive and non-legal-related time in a larger time entry. *See Target Nat. Bank v. Higgins*, 180 Wn. App. 165, 187, 321 P.3d 1215 (2014) ("Block billing entries obscured time performed on discrete tasks.").

F. Plaintiffs Should Be Awarded Their Costs on Appeal Under RAP 18.1

The Declaratory Judgment Act affords a court broad discretion to award costs. It provides: "In any proceeding under this chapter, the trial court may make such award of costs as may seem equitable and just." RCW 7.24.100. Having pursued a claim for declaratory judgment, Plaintiffs request an "equitable and just" award of costs on appeal.

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V. CONCLUSION

For the reasons set forth above, the trial court's grant of summary judgment in favor of Defendants voting should be vacated and the case should be remanded for entry of judgment in favor of Plaintiffs.

RESPECTFULLY SUBMITTED this 5th day of June, 2019.

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DECLARATION OF SERVICE

On June 5, 2019, I caused to be served a true and correct copy of the foregoing **APPELLANTS' CORRECTED OPENING BRIEF** to be served on counsel of record stated below, via the Washington Courts E-Portal:

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 5th day of June, 2019, at Seattle, Washington.

s/Thao Do
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Comments:

This corrected version of the brief adds citations to certain Clerk's Papers that were designated after the brief was filed. It also makes several minor corrections to punctuation and the like. The corrected brief contains no substantive revisions.

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